



BILLING CODE: 8070-01-P

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1238

RIN 2590-AB05

Stress Testing of Regulated Entities

AGENCY: Federal Housing Finance Agency.

ACTION: Final rule.

SUMMARY: The Federal Housing Finance Agency (FHFA) is adopting a final rule that amends its stress testing rule, consistent with section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). These amendments adopt the proposed amendments without change to modify the minimum threshold for the regulated entities to conduct stress tests increased from \$10 billion to \$250 billion; removal of the requirements for Federal Home Loan Banks (Banks) subject to stress testing; and removal of the adverse scenario from the list of required scenarios. These amendments align FHFA's rule with rules adopted by other financial institution regulators that implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) stress testing requirements, as amended by EGRRCPA.

DATES: This rule is effective: **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

FOR FURTHER INFORMATION CONTACT: Naa Awaa Tagoe, Senior Associate Director, Office of Financial Analysis, Modeling and Simulations, (202) 649-3140, naaawaa.tagoe@fhfa.gov; Karen Heidel, Assistant General Counsel, Office of General Counsel, (202) 649-3073, karen.heidel@fhfa.gov; or Mark D. Laponsky, Deputy General

Counsel, Office of General Counsel, (202) 649-3054, mark.laponsky@fhfa.gov. The telephone number for the Telecommunications Device for the Deaf is (800) 877-8339.

SUPPLEMENTARY INFORMATION:

I. Background

Section 401 of the EGRRCPA, (Pub. L. 115-174, section 401) amended the Dodd-Frank Act requirements to implement stress testing. Prior to the passage of the EGRRCPA,¹ section 165(i) of the Dodd-Frank Act² required each financial company with total consolidated assets of more than \$10 billion to conduct annual stress tests. In addition, section 165 required FHFA to issue regulations for regulated entities to conduct their stress tests, which were required to include at least three different stress testing scenarios: “baseline,” “adverse,” and “severely adverse.”³ In September 2013, FHFA published in the **Federal Register** a final rule implementing the Dodd-Frank Act stress testing requirements. FHFA’s regulation, located at 12 CFR Part 1238, requires each regulated entity to conduct an annual stress test based on scenarios provided by FHFA and consistent with FHFA prescribed methodologies and practices. The regulation also requires that the agency issue to the regulated entities stress test scenarios that are generally consistent with and comparable to those developed by the FRB not later than 30 days after the FRB publishes its scenarios.⁴

Section 401 of EGRRCPA amended certain aspects of the stress testing requirements applicable to financial companies in section 165(i) of the Dodd-Frank Act.⁵ Specifically, after 18 months, section 401 of EGRRCPA raises the minimum asset

¹ Pub. L. 115-174, 132 Stat. 1296 (2018).

² Pub. L. 111-203, 124 Stat. 1376 (2010), codified at 12 U.S.C. 5365.

³ 12 U.S.C. 5365(i)(2)(C).

⁴ 12 CFR 1238.3(b).

⁵ Pub. L. 115-174, 132 Stat. 1296-1368 (2018).

threshold for application of the stress testing requirement from \$10 billion to \$250 billion in total consolidated assets, revises the requirement for financial companies to conduct stress tests “annually,” and instead requires them to conduct stress tests “periodically”, and no longer requires the stress test to include an “adverse” scenario, thus reducing the number of required stress test scenarios from three to two.

II. Discussion of Public Comments

On December 16, 2019, FHFA published in the **Federal Register** proposed amendments to the stress testing requirements for the regulated entities. The comment period closed on January 15, 2020. FHFA received one comment which stated that the threshold of \$250 billion in total consolidated assets was too high and lowering the threshold to \$100 billion in total consolidated assets would be more appropriate.

EGRRCPA set the threshold at \$250 billion in total consolidated assets and the proposed rule reflects this statutory requirement. The Enterprises will continue to be covered by the rule at its new threshold, however, the Banks will not. After several years of assessing the Banks’ stress tests, FHFA believes that its other supervision tools are sufficient for the agency’s purposes, and that the additional burden on the Banks of conducting the annual stress tests is not necessary. FHFA retains under its general supervisory powers the discretion to require stress testing by the Banks if FHFA determines that it would be useful. Therefore, FHFA is adopting as its final rule the same rule proposed on December 16, 2019, without any change.

III. Summary of Final Rule

FHFA is adopting the proposed revisions to FHFA’s rule without change as follows: the rule discontinues the Dodd-Frank Act stress testing of the Banks; prescribes

the frequency of stress testing; and reduces the number of scenarios mandated for Enterprise Dodd-Frank Act stress testing. These revisions are described in more detail below.

A. Minimum Asset Threshold

As described above, section 401 of EGRRCPA amends section 165 of the Dodd-Frank Act by raising the minimum threshold for financial companies required to conduct stress tests from \$10 billion to \$250 billion. As there are no Banks with total consolidated assets of over \$250 billion, the Banks will no longer be subject to the stress testing requirements of this rule. As the total consolidated assets for each Enterprise exceed the \$250 billion threshold, the Enterprises remain subject to stress testing under this rule.

B. Frequency of Stress Testing

Section 401 of EGRRCPA also revised the requirement under section 165 of the Dodd-Frank Act for financial companies to conduct stress tests, changing the required frequency from “annual” to “periodic.” The term “periodic” is not defined in EGRRCPA. Because of the Enterprises’ total consolidated asset amounts, their function in the mortgage market, size of their retained portfolios, and their share of the mortgage securitization market, FHFA will continue to require the Enterprises to conduct stress tests on an annual basis. This is consistent with FHFA’s regulatory mission to ensure each of the regulated entities “operates in a safe and sound manner.”⁶

C. Removal of the “Adverse” Scenario

As discussed above, section 401 of EGRRCPA amends section 165(i) of the Dodd-Frank Act to no longer require the FRB to include an “adverse” stress-testing

⁶ 12 U.S.C. 4513(a)(1)(B)

scenario, reducing the number of stress test scenarios from three to two. The “baseline” scenario is a set of conditions that affect the U.S. economy or the financial condition of the regulated entities, and that reflect the consensus views of the economic and financial outlook, and the “severely adverse” scenario is a more severe set of conditions and the most stringent of the former three scenarios. Although the “adverse” scenario has provided some additional value in limited circumstances, the “baseline” and “severely adverse” scenarios largely cover the full range of expected and stressful conditions. Therefore FHFA does not consider it necessary, for its supervisory purposes, to require the additional burden of analyzing an “adverse” scenario.

IV. Coordination with the FRB and the Federal Insurance Office

In accordance with section 165(i)(2)(C), FHFA has coordinated with both the FRB and the Federal Insurance Office (FIO). On November 1, 2019, the FRB published a final rule which revised “the minimum threshold for state member banks to conduct stress tests from \$10 billion to \$250 billion,” and revised “the frequency with which state member banks with assets greater than \$250 billion would be required to conduct stress tests,” in addition to removing the adverse scenario from the list of required scenarios.⁷ The FDIC adopted its final rule;⁸ and the OCC its final rule.⁹ Although FHFA’s final rule is not identical to those of the FRB, the FDIC, and the OCC, it is consistent and comparable with them.

V. Paperwork Reduction Act

⁷ 84 FR 59032 (Nov. 1, 2019).

⁸ 84 FR 56929 (Oct. 24, 2019).

⁹ 84 FR 54472 (Oct. 10, 2019).

The final rule does not contain any collections of information pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501, *et seq.*). Therefore, FHFA has not submitted any information to the Office of Management and Budget for review.

VI. Administrative Procedure Act

This final rule is effective immediately upon publication in the **Federal Register**. Section 553(d)(3) of the Administrative Procedure Act (APA) provides for a delayed effective date after publication of a rule, except “as otherwise provided by the agency for good cause found and published with the rule.” The changes to part 1238 primarily cover how FHFA will implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) stress testing requirements, as amended by section 401 of EGRRCPA. These amendments, applicable to large financial companies, became effective on November 24, 2019. Consistent with section 553(d)(3) and for the reasons discussed below, FHFA finds good cause exists to publish this final rule with an immediate effective date. Without this rule, the Enterprises and Federal Home Loan Banks will be required to conduct stress testing under the prior rule, incurring additional expense and burden which FHFA has determined is not necessary for purposes of safety and soundness. In addition, an immediate effective date permits FHFA to synchronize its supervisory efforts related to stress testing with the FRB and the FDIC. Accordingly, the FHFA finds good cause for the final rule to take effect immediately upon publication in the **Federal Register**.

VII. Regulatory Flexibility Act

The final rule applies only to the regulated entities, which do not come within the meaning of small entities as defined in the Regulatory Flexibility Act (see 5 U.S.C.

601(6)). Therefore, in accordance with section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), the General Counsel of FHFA certifies that this final rule will not have a significant economic impact on a substantial number of small entities.

VIII. Congressional Review Act

In accordance with the Congressional Review Act (5 U.S.C. 801 et seq.), FHFA has determined that this final rule is not a major rule and has verified this determination with the Office of Information and Regulatory Affairs of the OMB.

List of Subjects in 12 CFR Part 1238

Administrative practice and procedure, Capital, Federal Home Loan Banks, Government-sponsored enterprises, Regulated entities, Reporting and recordkeeping requirements, Stress test.

Authority and Issuance

For the reasons stated in the preamble, and under the authority of 12 U.S.C. 5365(i), FHFA amends part 1238 of Title 12 of the Code of Federal Regulations as follows:

PART 1238—STRESS TESTING OF REGULATED ENTITIES

1. The authority citation for part 1238 continues to read as follows:

Authority: 12 U.S.C. 1426, 4513, 4526, 4612; 5365(i).

2. Revise § 1238.1 to read as follows:

§ 1238.1 Authority and purpose.

(a) *Authority.* This part is issued by the Federal Housing Finance Agency (FHFA) under section 165(i) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. 111-203, 124 Stat. 1376, 1423-32 (2010), 12 U.S.C. 5365(i),

as amended by section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), Pub. L. 115-174, 132 Stat. 1296 (2018), 12 U.S.C. 5365(i); and the Safety and Soundness Act (12 U.S.C. 4513, 4526, 4612).

(b) *Purpose.* (1) This part implements section 165(i)(2) of the Dodd-Frank Act, as amended by section 401 of the EGRRCPA, which requires all large financial companies that have total consolidated assets of more than \$250 billion, and are regulated by a primary federal financial regulatory agency, to conduct periodic stress tests.

(2) This part establishes requirements that apply to each Enterprise's performance of periodic stress tests. The purpose of the periodic stress test is to provide the Enterprises, FHFA, and the FRB with additional, forward-looking information that will help them to assess capital adequacy at the Enterprises under various scenarios; to review the Enterprises' stress test results; and to increase public disclosure of the Enterprises' capital condition by requiring broad dissemination of the stress test scenarios and results.

3. Revise § 1238.2 to read as follows:

§ 1238.2 Definitions.

For purposes of this part, the following definitions apply:

Planning horizon means the period of time over which the stress projections must extend. The planning horizon cannot be less than nine quarters.

Scenarios are sets of economic and financial conditions used in the Enterprises' stress tests, including baseline and severely adverse.

Stress test is a process to assess the potential impact on an Enterprise of economic and financial conditions ("scenarios") on the consolidated earnings, losses, and capital of

the Enterprise over a set planning horizon, taking into account the current condition of the Enterprise and the Enterprise's risks, exposures, strategies, and activities.

4. Revise § 1238.3 to read as follows:

§ 1238.3 Annual stress test.

(a) *In general.* Each Enterprise:

(1) Shall complete an annual stress test of itself based on its data as of December 31 of the preceding calendar year;

(2) The stress test shall be conducted in accordance with this section and the methodologies and practices described in § 1238.4 and in a supplemental guidance or order.

(b) *Scenarios provided by FHFA.* In conducting its annual stress tests under this section, each Enterprise must use scenarios provided by FHFA, which shall be generally consistent with and comparable to those established by the FRB, that reflect a minimum of two sets of economic and financial conditions, including a baseline and severely adverse scenario. Not later than 30 days after the FRB publishes its scenarios, FHFA will issue to the Enterprises a description of the baseline and severely adverse scenarios that each Enterprise shall use to conduct its annual stress tests under this part.

5. Revise § 1238.4 to read as follows:

§ 1238.4 Methodologies and practices.

(a) *Potential impact.* Except as noted in this subpart, in conducting a stress test under § 1238.3, each Enterprise shall calculate how each of the following is affected during each quarter of the stress test planning horizon, for each scenario:

(1) Potential losses, pre-provision net revenues, and future pro forma capital positions over the planning horizon; and

(2) Capital levels and capital ratios, including regulatory capital and net worth, and any other capital ratios specified by FHFA.

(b) *Planning horizon.* Each Enterprise must use a planning horizon of at least nine quarters over which the impact of specified scenarios would be assessed.

(c) *Additional analytical techniques.* If FHFA determines that the stress test methodologies and practices of an Enterprise are deficient, FHFA may determine that additional or alternative analytical techniques and exercises are appropriate for an Enterprise to use in identifying, measuring, and monitoring risks to the financial soundness of the Enterprise, and require an Enterprise to implement such techniques and exercises in order to fulfill the requirements of this part. In addition, FHFA will issue guidance annually to describe the baseline and severely adverse scenarios, and methodologies to be used in conducting the annual stress test.

(d) *Controls and oversight of the stress testing processes.* (1) The appropriate senior management of each Enterprise must ensure that the Enterprise establishes and maintains a system of controls, oversight, and documentation, including policies and procedures, designed to ensure that the stress testing processes used by the Enterprises are effective in meeting the requirements of this part. These policies and procedures must, at a minimum, describe the Enterprise's testing practices and methodologies, validation and use of stress test results, and processes for updating the Enterprise's stress testing practices consistent with relevant supervisory guidance;

(2) The board of directors, or a designated committee thereof, shall review and approve the policies and procedures established to comply with this part as frequently as economic conditions or the condition of the Enterprise warrants, but at least annually; and

(3) Senior management of the Enterprise and each member of the board of directors shall receive a summary of the stress test results.

6. Revise § 1238.5 to read as follows:

§ 1238.5 Required report to FHFA and FRB of stress test results and related information.

(a) *Report required for stress tests.* On or before May 20 of each year, the Enterprises must report the results of the stress tests required under § 1238.3 to FHFA, and to the FRB, in accordance with paragraph (b) of this section;

(b) *Content of the report for annual stress test.* Each Enterprise must file a report in the manner and form established by FHFA.

(c) *Confidential treatment of information submitted.* Reports submitted to FHFA under this part are FHFA property and records (as defined in 12 CFR part 1202). The reports are and include non-public information contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of, FHFA in connection with the performance of the agency's responsibilities regulating or supervising the Enterprises. Disclosure of any reports submitted to FHFA or the information contained in any such report is prohibited unless authorized by this part, legal obligation, or otherwise by the Director of FHFA.

7. Revise § 1238.6 to read as follows:

§ 1238.6 Post-assessment actions by the Enterprises.

Each Enterprise shall take the results of the stress test conducted under § 1238.3 into account in making changes, as appropriate, to the Enterprise's capital structure (including the level and composition of capital); its exposures, concentrations, and risk positions; any plans for recovery and resolution; and to improve overall risk management. If an Enterprise is under FHFA conservatorship, any post-assessment actions shall require prior FHFA approval.

8. Revise § 1238.7 to read as follows:

§ 1238.7 Publication of results by regulated entities.

(a) *Public disclosure of results required for stress tests of the Enterprises.* The Enterprises must disclose publicly a summary of the stress test results for the severely adverse scenario not earlier than August 1 and not later than August 15 of each year. The summary may be published on the Enterprise's website or in any other form that is reasonably accessible to the public.

(b) *Information to be disclosed in the summary.* The information disclosed by each Enterprise shall, at minimum, include—

- (1) A description of the types of risks being included in the stress test;
- (2) A high-level description of the scenario provided by FHFA, including key variables (such as GDP, unemployment rate, housing prices, and foreclosure rate, etc.);
- (3) A general description of the methodologies employed to estimate losses, pre-provision net revenue, and changes in capital positions over the planning horizon;
- (4) A general description of the use of the required stress test as one element in an Enterprise's overall capital planning and capital assessment. If an Enterprise is under conservatorship, this description shall be coordinated with FHFA;

(5) Aggregate losses, pre-provision net revenue, net income, net worth, pro forma capital levels and capital ratios (including regulatory and any other capital ratios specified by FHFA) over the planning horizon, under the scenario; and

(6) Such other data fields, in such form (e.g. aggregated), as the Director may require.

Dated: March 11, 2020.

Mark A. Calabria,

Director, Federal Housing Finance Agency.

[FR Doc. 2020-05476 Filed: 3/23/2020 8:45 am; Publication Date: 3/24/2020]